RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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January 26, 1983 **LETTER 853**

Jan. 14, DJIA 1080.85; PTI 1461; A-D Ratio –17.89
Jan. 21, DJIA 1052.98; PTI 1459; A-D Ratio –18.43

THE MARKET: From a Dow Theory standpoint, the primary trend must be considered up, and this conclusion is confirmed by the action of the major composite averages such as the Standard & Poor 500 and the NYSE Composite. Further confirmation is seen in the strong action of both the advance-decline ratio and my Primary Trend Index.

Up to early January, the action of the Averages had been a confusing see-saw affair. Had it not been for the steady upside progress of the PTI, I might have been frightened or at least highly skeptical. First Industrials, then Transports, would push to new recovery highs, but at no time did the recovery highs arrive together. Thus, it appeared we had a long series of non-confirmations.

But on the week ending January 14 the NYSE got its act together. The Dow recorded a record high of 1092.35 on January 10, the Transports recorded a confirming record high of 475.14 on January 12, and on January 13 the Utility Average rose to a 10-year peak of 124.68. From the standpoint of the Averages, one could hardly ask for better action than that.

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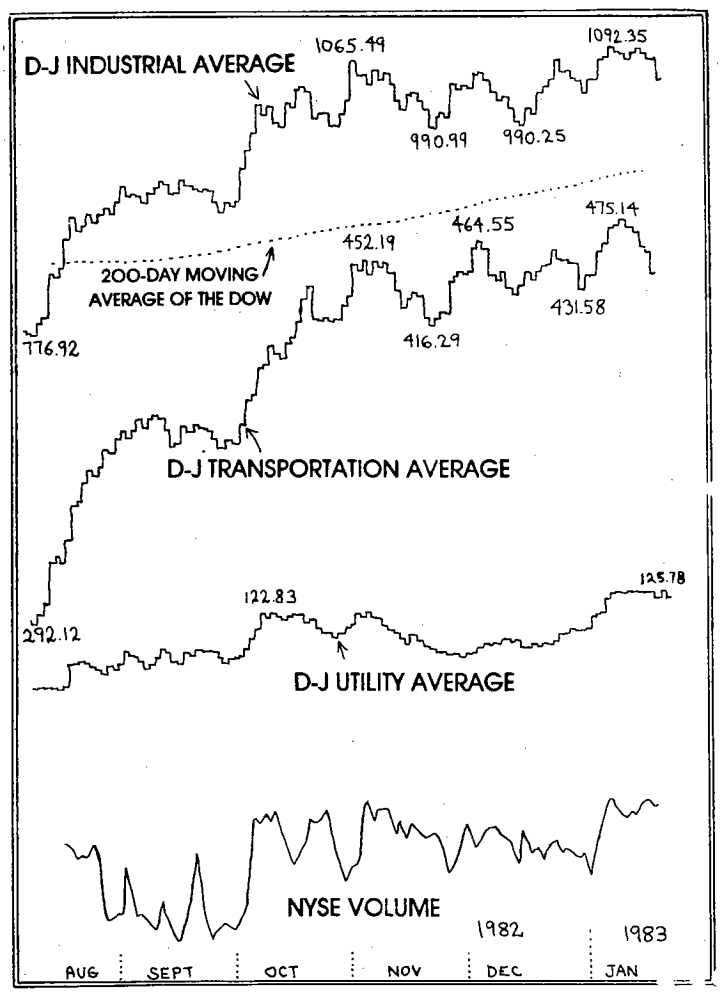


FRONT PAGE COMMENT: Why, why has gold been rising? The answer: because the dollar is the world's reserve currency, and the Federal Reserve Board is underwriting the dollar debts of the world. In effect, the Fed is turning trash debts into Federal Reserve obligations. If this continues (and I have every reason to believe that it will) we'll ultimately have a US currency backed by foreign junk loans, the dollar will collapse, and gold and the Swiss Franc and maybe the yen will be the only "monies" in the Free World that are worth a damn.

Many people believe that lending to foreign governments is not the function of commercial banks. Many others believe that the banks, having made rotten foreign loans, should suffer the consequences. I'm one of them. I believe the bank depositors should be saved, but the banks and their stockholders should pay the piper. Saving the busted banks will only mean greater excesses in the future. Who saves you or me when we make a bad investment? Why should the banks or their stockholders be any different?

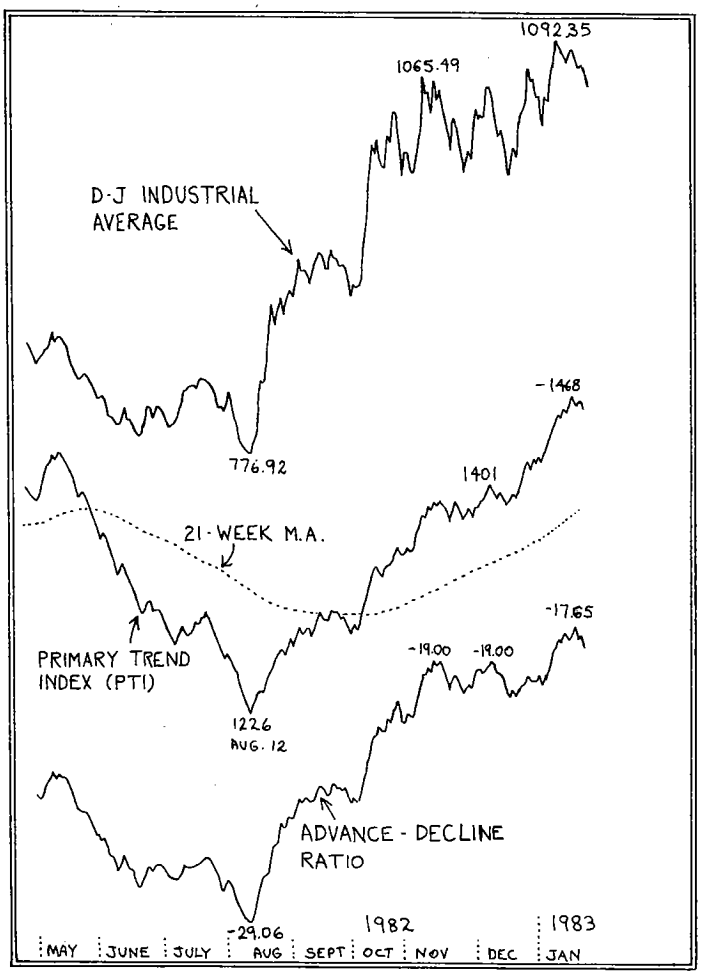
There are two bothersome items in the current stock market picture. The first is that my advance-decline line for the thirty Dow stocks recorded its high back on November 11. Despite new record highs in the Dow, the Dow A-D line has not confirmed. This could lead to trouble (its an indication of too few Dow stocks doing too much of the upside work).

The second technical sore spot concerns the daily new highs on the NYSE. Despite successive rallies to new highs on the part of the Dow, my 5-day average of daily new highs has been steadily sliding. The peaks in the 5-day index run as follows: Oct. 11, 457 new highs; Nov. 9, 303 highs; Dec. 7, 210 highs; Jan. 11, 184 new highs. Thus, fewer and fewer stocks are carrying this market.

Does this mean that the uptrend in the market is finished? Is the market ready to top out? It's obviously too early to tell, but my inclination is to turn to my proprietary index, the PTI. This index measures the BALANCE of technical strength or weakness in the market, and it measures it on a daily basis. So far, the PTI has looked strong on rallying days, while on declining days the PTI has given up points grudgingly. The net result (up to now) has been an unbroken uptrend in the PTI.

A study of the page 2 daily chart of the PTI shows a steady uptrend. As of last week the PTI was more than 80 points above its own 21-week moving average, and from this standpoint the market would appear to be rather extended (and in need of a rest). But ours is not to reason why. Suffice it to say that when the technical picture becomes sufficiently exhausted,the PTI will correct. If the technical picture turns bearish, we will see the PTI crack first its rising trendline and then its 21-week moving average.

The point and figure chart of the PTI provides an interesting 5-year perspective. Here we see the spectacular pattern which I have alluded to in recent Letters–a giant head-and-shoulders bottom in the PTI. The late action shows an uncorrected rise



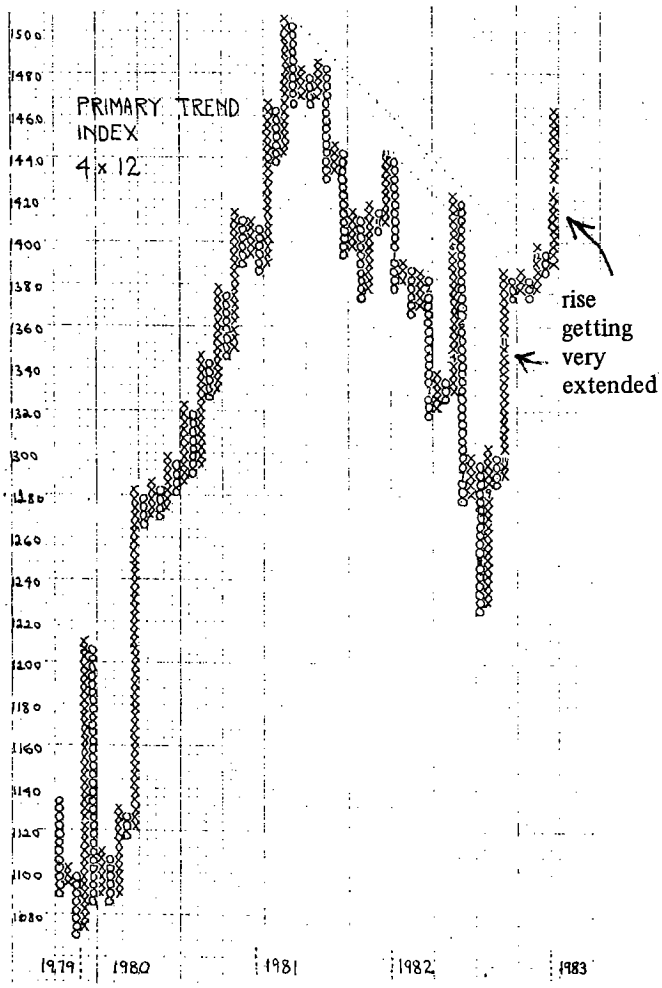
from 1392 in the PTI to last week's 1464. Thus, we are nearing the point where a consolidation or a correction must be expected. Nevertheless, the bottom formation in the PTI suggests a further and perhaps surprising bullish potential.

At the bottom of the chart we see that the advance-decline ratio on the NYSE (a proxy for ALL NYSE stocks) has been bullishly in gear with the Dow on the upside. A fascinating picture, but it would be nice if those new highs on the NYSE would start surging.

INVESTMENT POSITION: The bull will be master of this box as long as the PTI is in a rising trend (you can draw your own trendline on the daily chart of the PTI). Retention of common stocks and no-load funds is warranted as long as the PTI remains bullish.

Few people realize it, but the YIELDS on the 91-day T-bills hit their 1982-83 lows in August at 7%. The bill yields (despite Fed pumping) have not been lower since! Last week the bond market showed signs of weakness following a long, high level consolidation. My instinct is to say that the bonds have made their highs. Lighten up on longer-term bonds. If you're a trader, get out.

I remain a bull on gold. Gold items, as discussed in Letters since June, should be held. This includes Campbell Red Lake, ASA, gold coins and gold no-load funds. Gold is now pushing against "the big half-grand divide," the 500 level. The big even numbers (100, 500, 1000) always offer major resistanee, but when an item climbs above such numbers–watch out. (Note: the Dow attacked the 500 level for three years, 1956-58, before it left that level behind).



THE PICTURE: *Question:* Russell, January is about over. How does the economic situation look to you?

Answer: The operative words are "confusion" and "calculated risks." The fact is that if normal market forces were allowed to operate, we'd be witnessing a world collapse. Instead of this, as I've commented on so many times in these reports, we are seeing an orgy of credits. Credits from the IMF, the BIS, the Fed, the banks. The stunt is to try to paper over the disastrous international bank loans and somehow keep the banks, the US and the world functioning.

The Treasury is now hitting the market for up to $1 billion a working day and bank reserves are roaring up at a rate of around 20%. Depending on which direction you look, you can discern the specters of either inflation or deflation.

Question: What do you see coming out of Washington?

Answer: Confusion bordering on chaos. The latest is talk of a flat-rate tax in 1986, but you can be sure of one thing–any "reform" in taxes is going to cost you and me *more*. "Tax reform" is becoming the leading "buzz phrase" of the 1980's, and it's happening within the administration of a confused President who said he would never raise taxes.

On top of this, one thing that worries me is the military picture. The fact is that the Russians are pulling FAR ahead of the US

both in research and development and in actual production of advanced weapons systems. Unfortunately, Mr. Reagan is trying to build a Vietnam-age military, a military force that is rapidly becoming the biggest and costliest antique in history.

It is my firm belief that somewhere ahead (perhaps in 1984 or '85) we are going to hear the frightening news that the Russians have pulled years ahead of us in weapons systems. Then we will witness a "Sputnik" psychology with the US rushing into research and development in an hysterical attempt to build a modern military. The cost of this belated effort will be absolutely astronomical.

Question: Do you see inflation heating up again?

Answer: There are only two ways to handle the unbelievable debt build-up that we are now witnessing. You either renege on the debt (via perhaps a moratorium) or you inflate the debt away. On the international front, we are seeing rescheduling of some debt (which actually amounts to reneging on the principle) and in the US we are seeing the groundwork laid for a new round of inflation.

Gold, the metals, and the commodity markets are already discounting the new inflation and I believe we will see the new inflation hit the economy by mid-1983. At that time the Fed will probably allow inflation to run for a while since unemployment will remain at high levels. Then when inflation becomes rampant the Fed will have to clamp down again. Thus the Fed and the Administration will continue to play the old game of stop-start, pop and sputter.

With the debt situation basically deflationary, with creation of massive credits basically inflationary, the Fed has been attempting to hold the economy somewhere midway between these two forces. But each inflationary rise becomes more virulent, each deflationary slide becomes more forceful. All the while the potential for both hyper-inflation and deflationary disaster increases. We, as survivors, are caught in the center. We are attempting to stay sane and solvent in a world that has become both insane and insolvent.

Question: All very depressing, but what about the markets?

Answer: If we examine the action in the stock market, the metals markets, and more recently the commodity market, it is hard to escape the conclusion that there is a general flight out of paper money. The level of almost all the markets is rising. The rises may be erratic, they may be violent, but they are persistent.

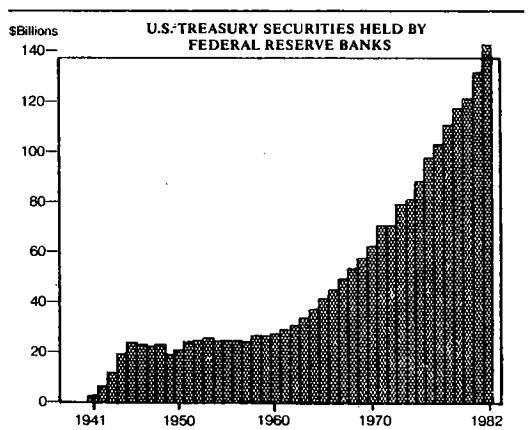
Question: What are we, as investors, supposed to do about it?

Answer: Sadly, I must report that I don't have THE perfect answer. But my imperfect answer (and I have said this before) is *diversification.* We just don't know whether we are heading into a period of wild inflation or whether some deflationary "accident" is going to happen (such as a major bank failure or a huge international default). So we *hedge our bets,* but always with the major trend of the various items in mind.

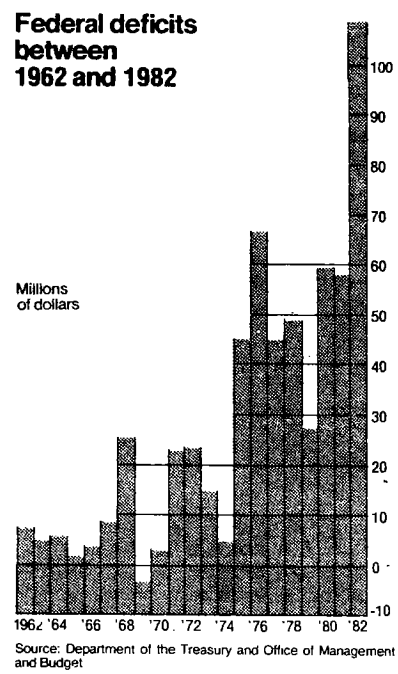
For instance, at this point 30% of your assets in common stocks is warranted. I would put perhaps 25% to 30% in gold-related items. You can put 15% of your remaining assets in 4-6 year T-notes and the rest in a liquid account such as a money market fund or in T-bills. In this way, you will be fairly well positioned for whatever comes up, and you will be invested with the bull trends in both the PTI and in gold.

PUMPING: One of the great fascinations of the markets for me is that they cut through all the political promises, the rumors, the gibberish and the hopes–and they zero in on the truth. Investors talk with their mouths, but they spend their money with their guts. We've been hearing endless talk about how inflation is simmering down, how the "fight against inflation" has been won, and why the Fed would not allow inflation to rekindle again.

Obviously, there is a lot of big money around that doesn't believe it. Why doesn't the big money, the smart money believe it? Simple, because they believe facts instead. For instance, between October 1, 1981 and December 1, 1982, the member banks purchased over $15 billion in US Treasury Securities (see chart). This is the initial process in the creation of new money.

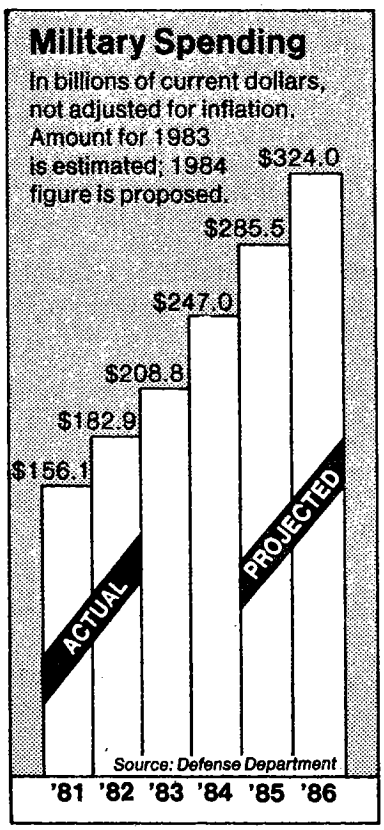


And why does the US need so much new money? That's an easy one too. Look at this second chart showing the Federal deficits since 1962. The chart doesn't show the deficit for the current fiscal year (1983-84) but pencil in a vertical line that reaches around $200 billion. That will give you some idea of the fiscal madness that is going on today.



Now look at the page 4 chart of actual and projected military spending. And you say that the President is being pressured to cut back around $11 billion in military spending? Well, you know what $11 billion will look like on this chart. It would hardly show. To make matters worse, a late report indicates that most of the increase in military spending is going down the inflation-drain. We're not getting any more for the increases in military spending–no, the cost of weapons systems (plus salaries and pensions) is simply going up.

So the wind-up is that with every passing day the ratio of dollars and dollar credits per ounce of gold climbs higher. It's like heat rising under a pressure cooker. Sooner or later the whistle goes off–warning of too much pressure.



WHERE AND WHEN: This is a tale of twenty years ago, and I put it in the category of "some things you have to learn the hard way." Well, I learned it, and maybe if I recite it to you it will save you a bit of blood, sweat and tears.

Back in 1964 an old-time market practitioner came to visit me. His name was Justin Barbour. There aren't many market students who remember Barbour's name today, but I want to tell you this man was brilliant. Barbour was a veteran Dow Theorist. In the July 6, 1942 issue of the Chicago Journal of Commerce (and I have a copy of this) Barbour's Dow Theory article appeared. In that article Barbour called for a bull market. This article was written two months after one of the most important stock market bottoms in history.

So I knew Barbour and I knew he was good, very good (Justin died about 10 years ago). At any rate, Barbour had moved to Corpus Christie, Texas, and he had moved down to do research. We talked for a long time about Dow Theory, about how Barbour had made a number of great calls, and we talked about what was coming up next.

"Richard," he said, "you know I've moved down to Texas for a reason. I've done a lot of research on one company down there, and it's Burroughs Corp. Richard, I've been out there a dozen times, I've researched this outfit, I've talked to the president, I've seen their production lines and I know their plans. Burroughs is going to come back–and big. And I've put half my assets in the stock of Burroughs."

Now Burroughs was a stock that had topped out in 1957 at 13, fell back to 7, rallied again to 13 in 1962–and then collapsed in 1964 to 5. Burroughs was known as a loser, a has-been. So I was a bit skeptical of Barbour's analysis, but I knew Barbour, and I did have a lot of respect for his abilities.

So I bought a thousand shares of Burroughs at around 5½. Well, the stock dawdled around, it rose to 6, back to 5; up to 7, back to 5. By the end of 1964 I was worn out watching Burroughs. I was beginning to hate the stock.

Then, wonder of wonders, BGH started up in January, 1965. By April it hit 9½. It dropped back to 7 (this was getting ridiculous) but in late-1965 BGH boomed to 11. I had doubled my money, and in a mood of sheer exuberance I sold the stock and took my profits.

What happened next? In 1967 BGH climbed to 22, in 1968 the stock hit 64, in 1969 BGH went over 80. The stock corrected in 1970, then shot up to a peak of 125 in 1973.

What had I done? I had doubled my money, but I had missed the greatest part of the whole bull move in Burroughs. I had sweated through the base building. I had fretted and twitched while BGH built its base, and I thought I was a genius when the stock finally doubled. But the guys who bought BGH from me at 11 saw the stock explode for another 110 points. They made the real money in BGH.

So what did I learn? I learned that you don't necessarily have to buy a stock or the market while it is basing. If the base is valid, you can buy the stock at or near the breakout point, and the odds are fairly good that the major portion of the move will lie ahead. Now the public will usually come in at the top one-third of the bull market, and don't kid yourself, the public will make money–for a while (if they weren't making money they wouldn't continue to buy). The only trouble is that the public keeps buying heavily right past the top, and they usually continue to buy right through the first third of a bear market. Then they will switch and the public will do its heaviest selling during the final third of the bear.

NOTES & QUOTES: Panic in the White House: I've said over and over that on the day that President Reagan took office, he should have told the American people the full story of the disastrous buildup of debts and deficits. Now it's clear why Mr. Reagan failed to tell the people the story. He didn't understand it himself. He still doesn't.

With deficits moving into the $200 billion and beyond phase, the White House staff itself is panicking. It appears that the staff is attempting to stampede poor Mr. Reagan into what is charitably referred to as a "mid-course correction." Of course, the correction has to do with taxes. Having failed to cut spending, having failed to reduce the budget deficit, the Republicans are now frozen with terror at the sight of what faces them. Even the President's buddy, Senator Laxalt of Nevada, admits that he is taken aback by the "terrifying" deficits. Next step: expect "tax reforms" that are going to cost you and me more. What not to expect–meaningful cuts in any area of the budget.

On the media front, sadly, President Reagan is reduced to protesting that he's not a shnook. And fewer and fewer people seem to believe him.

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Merrill Lynch's research dept. is expecting "a more rapid revival in the economy than is expected by the consensus economic forecast," but they doubt the recovery will be normal. They feel the contrary expectation is that "the compressed bull market cycle and rapid rise in stocks may be forecasting a rapid but

relatively short economic recovery." Merrill's research dept. has been good, and I would not discount this opinion.

In the meantime, I was flabbergasted by Dines' latest letter. Says Dines, "we think Reagonomics will not only do better than many now expect, but that a boom lies just ahead that will be spearheaded by the automotive and construction industries. This is the time to buy a car and house, before the crowd arrives." This is an extraordinary switch on the part of Dines, andI have respect for his long-term views. Dines notes that "doom and gloom" is now accepted, and therefore he is increasingly skeptical. One section of the new Dines report is headlined, "Is The Depression Over?" Dines seems to think that it is.

What do I think? I think we are going to muddle through for a while, perhaps quite a while longer. I think the politicians will opt for inflation over unemployment. I think we are going to have stag-flation with a very mixed economy (some disaster areas, some boom areas). I think the huge and continuing defense build-up will have long-term, very inflationary consequences. I think investors are going to have to stay very diversified during a period of rapid and violent trend changes in various areas.

But there's one nagging question on my mind. What if inflation doesn't take? What if the Fed hasn't inflated enough or what happens if people continue to pull back on their spending and the money velocity caves in? If that occurs we will see massive deflation as the debt crushes the economy and prices collapse. That's the little shadow that haunts me. To put it another way, what if deflation gets out of hand?

* *

Occasionally someone asks me, "Russell, what do you do for a living?" I usually answer, "I teach people how not to lose money." That answer is not as facetious as it sounds. Actually, if you can learn how not to lose money, it's usually just a matter of time before you make money.

Now along these lines one of my pet peeves is gambling. You know, it's really strange, but everyone tells me how much they won on this or that day in Vegas. Nobody ever seems to lose–it's amazing. Or is it that people forget the days on which they've lost their shirts, and they only talk about the occasional day when they've won. If all stories about the people who won in Vegas or Atlantic City were true, the casinos would be broke. But the casinos are anything but broke, believe me.

For instance, take these latest statistics from nine Atlantic City casinos. For the single month of December, the total casino winnings were $114 million. Divided among nine casinos this comes out to an average of $12.6 million per casino for the month. On a daily basis per casino the figure is $408 thousand. In other words, the nine Atlantic City casinos took in an average of almost half a million dollars a day or exactly $17 thousand an hour. This is just Atlantic City (remember, there's Las Vegas too). And they call it gambling? I call it legal confiscation. I still fail to comprehend the personality of the person who takes his hard-earned money and dumps it at the casinos at the rate of $17 thousand per hour!

	Dec. 1982	Nov. 1982
Bally's Pk Pl	$16,108,390	$16,428,332
Caesars Bdwk ...	14,267,658	14,020,797
Claridge	6,257,692	7,857,915
Golden Nugget ..	18,507,496	14,082,172
Greate B Sands	10,224,556	12,006,637
Harrah's	12,278,207	15,807,190
Playboy	9,357,689	11,901,634
Ramada Trop. ..	11,220,779	12,778,698
Resorts Int'l	16,345,697	18,107,547
Totals	114,568,164	122,990,922

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The 1982 pages for those of you who have the A-D ratio albums and the D-J Averages albums will be ready within a few weeks. But I need to know who wants these pages. The price for the album pages as always is $2 a page. Please, please, if you want your up-dated pages send in your money now (I will gauge the printing by the number of orders I receive).

* *

Next year will be a landmark for me–a quarter of a century of this crazy business. During all that time I have never taken as much as a full week off from my work. During all that time I have never missed writing a single issue of this letter. I used to think about retiring some day. But I guess I've changed my mind. I really think it's a mistake to retire–at least for me. What would I do? Would I look at the ocean all day, or maybe devote my life to golf (which I don't even play?). No, the markets have always fascinated me, and the fact is that this work is tiring but it's not really work at all as far as I'm concerned. I love doing what I'm doing, and I don't plan to retire until I'm too old or decrepit to hold a pencil.

But I'm warning all you readers. I'm thinking of doing a little bit of traveling. For instance, the last time I was in Europe was during WW II, and I wasn't touring at the time–I was dropping bombs courtesy of the Twelfth Air Force. Paula and I have been thinking of taking maybe a ten-day vacation to London and Paris, and we may even do it–that's assuming that 2-year old Lauren will not suffer some kind of trauma while we're away. At any rate, I'm ready to be a bit more adventurous. You only live twice, you know!

LATE NOTES:

If ever a market was geared to interest rates, this one is. Since early-October the bond market has been forming a huge top. Last Friday (Jan. 21) the top appeared to crack. Treasury bonds fell as much as two points on the session and long-term Treasury yields (despite profuse Fed pumping) pushed into the 11% range. The yield on the 91-day T-bils popped .25% to 8.25% (the low last August was 7%).

With interest rates moving up again, I feel that the test for this market is about here. In Dow Theory terms, I would want to see Industrials crack 990.25 and Transports break 416.29 before turning bearish. For the PTI, the critical level is about 1400; this is the level of the trendline that ascends from the August 12 low.

Personally, I feel comfortable with a position of "not too much" in any one area. I also feel comfortable with a position that is thoroughly diversified.

GOLD: Gold buyers have been looking ahead. And what they have seen (rightfully or wrongfully) is a great monetary inflation, based on an almost orgiastic explosion in credits and loans–all in an effort to hold up the world banking system and the various bankrupt and near-bankrupt nations. A second reason for the gold rise is the belief that the Fed, in ballooning the US money supply, has exceeded all sane limits. The new flood of liquidity, believe the gold buyers, will show up in inflation during 1983, and maybe even early in 1983.

I am including here a most informative chart (courtesy of Deliberations, Box 182, Adelaide St., Station, Toronto, Ontario, Canada M5C 2J1). This weekly chart does not present a picture of a quick pop based on fear of a world banking crisis. No, the

picture that I see here is that of a massive head-and-shoulders base, a structure built by planned accumulation. The accumulation began in mid-1981 and continues to the present.

In the meantime (see insert on gold chart) the gold stocks appear to be discounting higher prices for gold. ASA, the holding company, rose to within 12 points of its all-time high while a few of the individual S. African shares have rallied to record highs. Campbell Red Lake (the leading Canadian mine) has also risen to an all-time high.

One of the reasons for the gold shares leading the bullion, of course, is the yield of returns offered by the shares. Based on the prices paid for the shares near the 1982 lows, many of the gold stocks are now providing yields of up to 25%. I recommended ASA in 1982 in the 35 range. With a dividend of $6, ASA on the original purchase would provide a yield of 17%. Thus, it isn't hard to see why seasoned investors bought the shares ahead of the bullion.

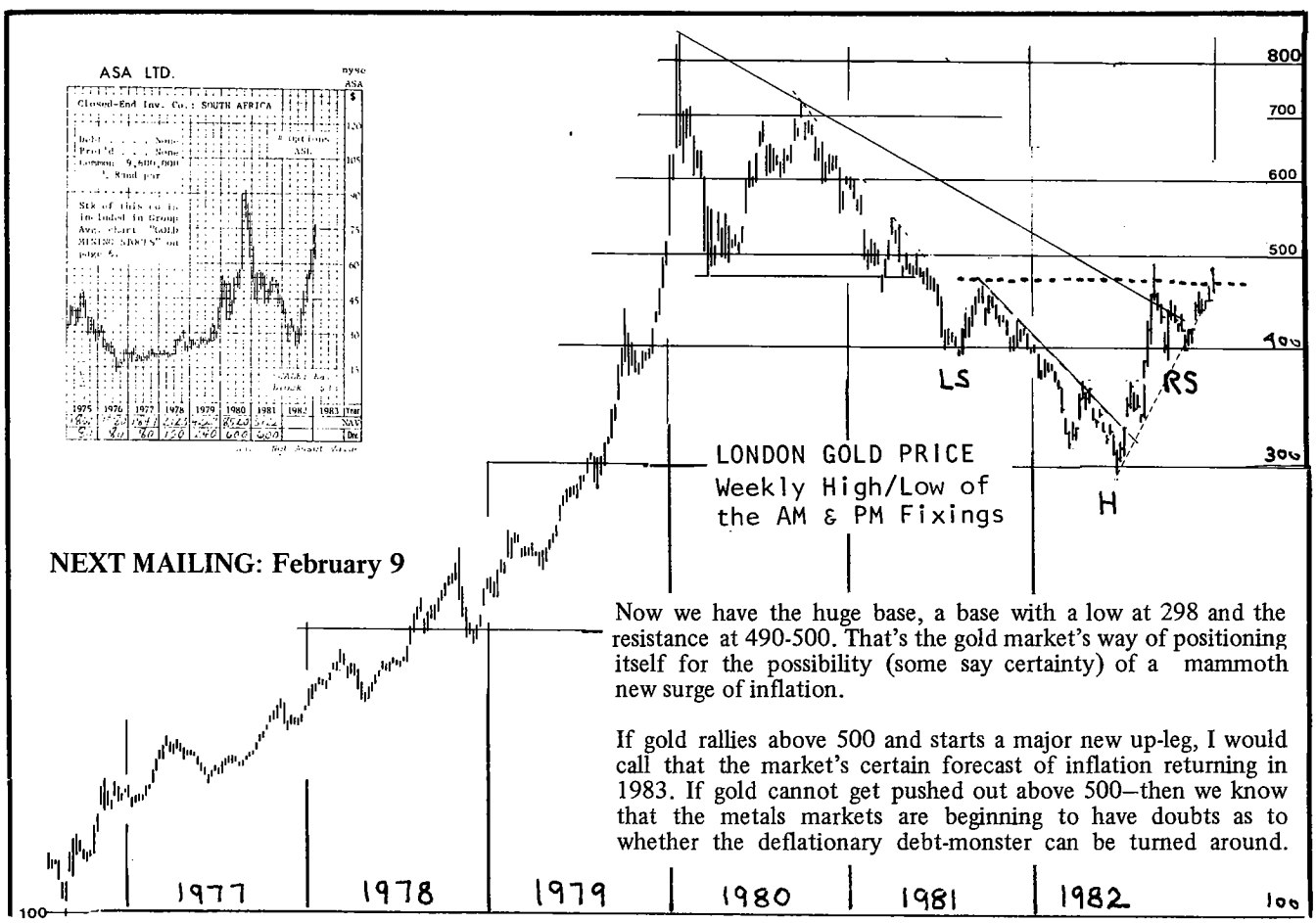
I have another theory about gold and gold shares. When a big bull market gets started, the bull generally likes to sneak up as far as possible before being discovered by the public. Now the public knows about and hears about the price of gold (it is announced on every news broadcast). But the public (and most professionals) have no idea whether Homestake or ASA or Vaal Reefs are far below, near or over their all-time highs. Thus, the stocks have made a massive bull move under cover of gold below 500. Had gold pushed to record highs (as many of the gold shares have) the whole world would have known about it. Thus, the sly gold bull has his methods of sneaking up–unseen and unheralded.

In my opinion, gold has now completed the first phase of its bull market. When gold pushes decisively above the 500 level, the second phase of the bull market will start. The first phase is the accumulation phase, the phase when smart money buys despite adverse (for gold) fundamentals. The second phase will see the entrance of ordinary investors, and it is here that some of the reasons for buying gold will become clearer. The third phase of the bull market (probably far in the future) will see the public enter the gold picture. At that point (during the third phase) the reasons for buying gold will be screamingly apparent for all to see.

A point of technical interest is the measurement afforded by the head-and-shoulders bottom in gold. As a rule (particularly during a bull market) an item will move as far above the resistance (horizontal dashed line on chart) as the distance from the head (marked H on chart) to the resistance. Taking the measurement, I get upside count or projection of about 750 for gold. Such a rise would take gold up to the late-1980 high marked X on the chart.

As noted earlier the 500 ("half a grand") level usually offers tough resistance for any price movement. But if gold pushes above 500, then holds stubbornly above that level, it will have achieved a major technical break-through.

The exponential moving averages (illustrated in the last Letter) have been of great help to me in gauging this gold move. As of now, the primary or 50-week MA for bullion is at the 412 level, the 13-week or intermediate MA is at 449, and the more sensitive 5-week MA is at 474. Gold holding above 474 on any correction would be a sign of strength.



NEXT MAILING: February 9

Now we have the huge base, a base with a low at 298 and the resistance at 490-500. That's the gold market's way of positioning itself for the possibility (some say certainty) of a mammoth new surge of inflation.

If gold rallies above 500 and starts a major new up-leg, I would call that the market's certain forecast of inflation returning in 1983. If gold cannot get pushed out above 500–then we know that the metals markets are beginning to have doubts as to whether the deflationary debt-monster can be turned around.